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CFEP DRAFTING GROUP
ECONOMIC DEFENSE POLICY REVIEW

Staff Study No. 6
Draft of June 23, 1955

Differences in Free World Controls Over Trade with the
European Soviet Bloc and Communist China

This draft of Staff Study No. 6, "Differences in Free World Controls over Trade with the European Soviet Bloc and Communist China", is transmitted for your use in connection with the work of the CFEP Drafting Group on Economic Defense Policy Review.

In compliance with the request of the Chairman of the Drafting Group, the Executive Secretary, EDAC, is providing reproduction and distribution facilities as a service to further the work of the CFEP Drafting Group.

Irving I. Kramer
Executive Secretary

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ECONOMIC DEFENSE POLICY REVIEWStaff Study No. 6
(Draft of June 23, 1955)Differences in Free World Controls Over Trade with
the European Soviet Bloc and Communist ChinaAbstract

There is at present a wide difference between the Western trade controls applied to Communist China¹ and those applied to the European Soviet Bloc. The stringent UN embargo against exports of strategic goods to Communist China coupled with the August 1954 relaxation in the level of trade controls against Communist Europe by COCOM has resulted in a much longer list of goods which are embargoed for export to Communist China than to the European Soviet Bloc. In addition, among other things, unilateral US controls prohibit importation of goods from and remittances of all kinds to Communist China.

Impact on Communist China of present differential:

1. The longer list applied to Communist China can slow delivery, but cannot deprive that country of goods which are not also denied to Communist Europe. These goods can be imported by Red China via European Bloc ports in bloc shipping reserved for this purpose, while non-bloc shipping can be utilized for the transportation of uncontrolled goods. Thus, only those goods on the shorter COCOM lists can be effectively denied to Communist China.

1. The term "Communist China" is used in this study to cover Communist China and North Korea.

Also cover the possibility that P.C. in conformity with a general policy of trade with Communist China will trade with the United States and other countries.

and add to costs of delay in getting goods to the front lines for the war effort. This is a major factor in the loss of the war effort. This is a major factor in the loss of the war effort. This is a major factor in the loss of the war effort.

2. The restricted sources of supply and transshipment, however, carry an economic burden due to the increased cost of transportation and the increased prices which must frequently be paid for the listed goods. This cost is roughly estimated at \$30 million for the year 1954. However, the initial impact of differential trade controls appears to have subsided, probably as a consequence of economic adjustments in both Communist China and its trading partners in the Sino-Soviet Bloc.

3. The differential in Western export controls has the paradoxical effect of losing for Communist China some of its foreign markets, principally Japan. Japan is willing to purchase Chinese goods but since it cannot export the items on the CHINCOM increased list or provide China with foreign exchange usable elsewhere, Chinese exports to Japan are probably \$35-65 million per year below what they would be in the absence of the differential in export controls.

4. The most important single control applied against Communist China but not against the rest of the Soviet Bloc is the unilateral US prohibition on China's ability to receive dollars from the US for exports to or remittances from the US. It is estimated that this costs Communist China roughly \$130-150 million a year. The loss of the US market seriously curtails Communist China's ability to import goods from all sources including the rest of the Soviet Bloc.

The impact of these various controls can be seen when compared with the fact that Communist China's imports from all sources amounted to about \$1.25 billion in 1954. Thus, the differential in controls applied by countries other than the US cuts China's imports of all goods by at least

Footnote frozen assets 11

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5 percent. At least 10 percent more is subtracted by the unilateral US financial controls. If this minimum of \$195²⁴⁵ million were used to import metals, machinery, and equipment, Communist China could have increased its investment in these items by an estimated 15¹⁸ percent in 1954.

Elimination of differential:

Since the Geneva Conference pressure has been mounting among our allies to reduce controls against Communist China. Most countries are motivated either by neutralist sentiments or by a feeling that increased trade would reduce international tension and, therefore, the risk of armed conflict. The latter is important in the UK. Economic considerations are not large and are important ^{primarily} only for certain Japanese businessmen and political leaders. Many Japanese also feel that their country is at a disadvantage vis-a-vis the Western European countries in the indirect trade with Communist China. Portugal is concerned because of Macau.

The elimination in the differential in export controls applied to Communist China* would not, to repeat, allow that country to purchase ^{many types of} goods which it otherwise could not have purchased in the West. It would reduce the cost of such purchases and increase the country's export earnings so that the total volume of trade might rise by ^{at least 10% (both ways)} some 5 percent. Continuation of unilateral US financial controls would, of course, deny Communist China an increase of some 10 percent which it could otherwise achieve through its receipts of dollars from the US.

The elimination of the differential in controls could also be achieved by raising the level of controls against the European Bloc. Such a policy would deny to Communist China those goods which can now be transshipped through

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* Meaning of elimination of differential is not explicit. If C. China was granted a quota for I/I/I items, a present quota enlarged, C. China would be able to obtain items not now available for transshipment via European Bloc.

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Eastern European ports, assuming that all COCOM members would agree to and enforce the changed control lists. However, such a course of action does not now appear feasible, especially since it follows closely on the heels of a substantial reduction in COCOM controls against the European Bloc and various positive conciliatory moves on the part of the USSR.

*Might at least
put the items on the II
and hold quotas to needs of
USSR and its satellites.*

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**I. DIFFERENCES IN LEVEL OF EXPORT CONTROLS AGAINST COMMUNIST CHINA AND THE
EUROPEAN SOVIET BLOC**

A. Historical Background

International agreement to apply unified trade controls against the European Soviet Bloc became effective in January 1950 with the establishment of a Coordinating Committee (COCOM) by the major Western allies to direct and coordinate trade control policies of the countries concerned. The COCOM countries, now numbering 15,¹ agreed to control three lists of commodities for the purpose of limiting the military potential of the Bloc. Goods on International List I (IL-I) are embargoed for shipment to the Bloc, goods on List II (IL-II) are subject to certain quantitative export controls, and goods on List III (IL-III) are subject to surveillance and exchange of information on shipments to the Bloc by the COCOM countries.

In June 1950 Communist China and north Korea were included in the scope of the export controls exercised by COCOM countries. In December 1950, after the Chinese Communist aggression in Korea, the US completely embargoed its trade and shipping with Communist China. In addition to trade controls maintained by other cooperating nations against Communist China, the US has put into effect the following unilateral controls:

1. Transaction and import controls which effectively prohibit imports from Communist China and the use of US dollars in transactions involving a Chinese Communist interest.

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1. Member countries are: Belgium, Canada, Denmark, France, Greece, Germany, Italy, Japan, Luxembourg, the Netherlands, Norway, Portugal, Turkey, the UK, and the US.

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2. Export controls which embargo all American goods to Communist China.
3. The denial of permission to American flag ships to visit Communist China and of their carrying any cargo intended for that country.
4. The prohibition of bunkering in the US of any foreign ships destined to call at Communist China within 120 days following, as well as the mandatory refusal by any American Petroleum Company of bunkering overseas of foreign ships carrying strategic cargoes to Communist China, either on outgoing or returning voyages.

After the UN embargo resolution of May 18, 1951, the COCOM countries expanded their controls on trade with Communist China, and 30 other countries imposed restrictions on their exports to Communist China. By the fall of 1952 all COCOM countries had agreed to embargo for shipment to Communist China all items on the three international lists as well as certain supplementary items, and organized the China Committee (CHINCOM) to coordinate these controls. Although enforcement measures have not been uniform, various COCOM countries have applied controls on their own merchant shipping, bunkering, transshipment of goods, financial transactions, and have taken other measures to reinforce their trade control policies.

Trade controls against Communist China have thus become considerably more comprehensive than those applied against the USSR and Eastern Europe, and the gap between them was substantially increased in August 1954 when the

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COCOM countries agreed to a major relaxation in trade controls against the USSR and Eastern Europe. Trade controls against Communist China were maintained without effective change, however, and the COCOM countries agreed to consider measures to prevent or reduce the evasion of these controls by transshipment of goods through other Soviet Bloc countries, the opportunities for which had obviously been increased by the relaxation of trade controls against the European Soviet Bloc.

B. Communist China's Foreign Trade

During the past five years Communist China's foreign trade has steadily expanded. Following the unification of the Chinese mainland under Communist control there was rapid progress in reconstruction, and Communist China's foreign trade more than doubled between 1950 and 1954, reaching the approximate equivalent, in constant dollars, of the highest prewar levels. At the same time Communist China has reoriented its trade toward the Soviet Bloc ^{in part} primarily because of Communist policies designed to isolate the economies of Bloc countries and to eliminate dependence on trade with the Free World. Of course, Soviet and satellite military and economic assistance has supported these policies, which have been given further impetus by Free World trade controls.

Estimates of Communist China's total trade, and its division between the Sino-Soviet Bloc and non-Communist areas, from 1950 to 1954 are presented in Table 1. (see next page).

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Table 1. COMMUNIST CHINA'S ESTIMATED TRADE WITH THE
SINO-SOVIET BLOC AND THE FREE WORLD, 1950-1954

| Year | Total trade In billions of US dollars | Percent of Total Trade ¹ | | | |
|------|---|-------------------------------------|---------|--|---------|
| | | Chinese Communist trade data | | By estimated origin and final destination | |
| | | Bloc | Nonbloc | Bloc | Nonbloc |
| 1950 | 1.1 | 26 | 74 | 26 | 74 |
| 1951 | 2.2 | 61 | 39 | 61 | 39 |
| 1952 | 1.8 | 72 | 28 | 67 | 33 |
| 1953 | 2.2 | 75 | 25 | 68 | 32 |
| 1954 | 2.5 | 80 | 20 | 75 | 25 |

1. Analysis of free world trade data and other intelligence indicates that Chinese Communist trade announcements since 1952 have exaggerated the extent of its reorientation toward the Sino-Soviet Bloc. This distortion is believed to reflect the "middleman role" played by European Soviet Bloc countries, which are believed to market Chinese Communist exports in Western Europe and to purchase controlled goods for transshipment to Communist China. Although this trade is with the free world, the Chinese Communists may record it as trade with the Sino-Soviet Bloc.

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II. ECONOMIC IMPACT OF PRESENT DIFFERENTIAL IN CONTROL

On Communist China

How do we know that the US has been alone in closing its markets to Communist China? Every time we have purchased direct from Communist China.

The differential in the trade controls applied to Communist China above those applied to the European Soviet Bloc has retarded the Chinese economic program by decreasing foreign exchange receipts and increasing import costs. The differential export controls have ^{not} denied to Communist China any goods which are available to the European Soviet Bloc though deliveries were delayed. These goods have been available to China ^{to the extent that they were} after being transshipped from European Bloc ports. However, Communist China could have increased its total imports in 1954 by at least \$195 million or over 15 percent in the absence of differential trade controls. Of this, \$65 million is due to the differential in export controls; the remaining \$130 million flows from the unilateral US controls over dollar payments to Communist China.

The US, which has been alone in closing its markets to Communist China's exports, took nearly \$150 million or over one-quarter of Communist China's exports in 1950. The US market was almost unique in its demand for such important Chinese exports as tung oil, bristles, feathers, embroideries, and handicrafts. These products could find only limited alternative markets and the resources used in their production being largely marginal in character were not easily diverted to other types of production. Although the US has found substitutes for some of these products and alternative sources of supply for others, Communist China could have increased its exports to the US in 1954 by an estimated \$100 million in the absence of unilateral import controls. Furthermore, US financial controls cost the Chinese Communists an estimated \$30-50 million in foreign exchange annually by prohibiting dollar remittances

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* If frustration is this complete & assured, the NSC was very unrealistic in its policy statement in NSC 152/2 & 3.

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from overseas Chinese. The denial of these dollar funds from exports and remittances has annually reduced by \$130-150 million Communist China's foreign exchange receipts which could be used to purchase imports not on the COCOM lists whether or not the US reduced its export controls.

The Japanese market for Chinese Communist exports is extensive but tends to be competitive with that of the Soviet Union, which is now absorbing commodities that Japan formerly imported from China, such as coal, iron ore, salt, soybeans, hides, textile fibers, and other foodstuffs and raw materials. It is estimated that Japan could have absorbed a maximum of \$300 million of Communist China's exports in 1953, but this level of imports would have required a considerable reorientation of Communist China's trade. Given the absence of Japan's export controls and Communist China's relaxation of its political warfare campaign against Japan, Communist China could export to Japan \$75-100 million of goods annually (compared to \$40 million in 1954) without altering substantially its commitments to other markets and without foregoing the advantage of the higher prices prevailing in the Japanese market.

The Chinese Communists have been burdened with increased imports costs amounting to very roughly \$30 million in 1954. These added costs consisted of a premium of \$20 million above world market prices paid by the Chinese Communists to secure rubber from Ceylon, and at least \$10 million for other costs imposed by differential controls. Free World goods transshipped via the Eastern European Bloc in 1954 totaled 110,000 tons. Through direct shipments of these goods the Chinese Communists might have saved as much as \$3 million in transport costs alone. Moreover, through wider access to world markets -- such as the US market and the Japanese market -- Communist China could have purchased more

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competitively and thus at lower prices. Savings would have been especially significant in the cases of: a) the controlled commodities of Western European origin that are purchased through speculative elements and reach Communist China through circuitous channels, and b) petroleum shipments which constitute a considerable strain on the rail transport facilities of both the USSR and Communist China and which in the absence of CHINCOM controls could be secured by direct shipments at considerable savings.

In summary, the differential in trade and financial controls: 1) does not deny Communist China any specific goods, 2) decreases the availability of foreign exchange to Communist China by \$165-210 million per year, and 3) increases the cost of Chinese imports by at least \$30 million per year. This minimum total of roughly \$195 million amounted to over 15 percent of Communist China's imports from all sources in 1954. The cut is especially significant when one notes that imported metals, machinery and equipment, estimated at over \$700 million in 1954, constituted over one-half of the total investment in such items budgeted by the Chinese Communists in 1954. Thus, an added \$195 million could have increased such investment by over 15 percent.

What evidence?
"... his probably substandard"
The initial impact of the differential in trade controls on Communist China appears to have subsided, probably as a consequence of economic adjustments in both Communist China and its trading partners in the Sino-Soviet Bloc.
Immediately after controls were imposed, the Chinese Communists offered high prices for strategic goods in Hong Kong. However, this situation changed after 1951, and by 1954 reports from Hong Kong indicated only sporadic interest on the part of Communist China to obtain strategic goods through illegal channels in Hong Kong. Exports of strategic goods from Macau, which had been a major

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loophole in the enforcement of trade controls, declined in 1954 compared to 1953 owing in part to action by the Portuguese Government to enforce controls, and in part to a lack of firm offers from the Chinese Communists. Trade in strategic goods through Hong Kong and Macau, both of which were high cost intermediaries for obtaining these materials, was apparently displaced in part by purchases from West European sources in 1953 most of which were transshipped to Communist China through European Soviet Bloc ports. These transshipments increased substantially during that year compared to 1952. However, the decrease in these diversions from non-Communist Europe during 1954 suggests that the Chinese Communists 1) have found alternative sources of supply in other countries of the Sino-Soviet Bloc, 2) have increased their domestic output sufficiently to satisfy more completely their needs for strategic goods, or 3) have been forced to reduce purchases because of shortages of foreign currencies and unfavorable barter trade balances given impetus by agricultural production shortfalls and saturation of foreign markets with typical mainland Chinese products. Combinations of all the factors, and other minor influences, are of course possible explanations of this decrease in diversions.

Differential trade controls provide Communist China with an issue in their effort to isolate the US from its allies. Although controls hinder their efforts to achieve economic penetration of other Asian countries, the Chinese Communists continue to hold out the prospect of advantageous trade to these countries in order to arouse resentment toward the control system and policy conflicts with the US.

B. On Communist Europe

The impact of the differential in export controls has been slight on the countries of Communist Europe. Some of these countries, notably Poland, have engaged in a profitable transshipment trade. Others have undoubtedly supplied

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off-20 subject

It is to be noted that Communist China is making good at its promises of penetration of the Sino-Soviet Bloc toward the US?

What basis?

Argument of the US - need to be

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Communist China with goods which it ordinarily received directly from the West. Since these exchanges have been on a commercial basis, there has been no net cost and some economic gain to the countries of the European Soviet Bloc.

There is no evidence that the necessity for closer economic relations in the Sino-Soviet Bloc has had any marked impact on their political relationships.

C. On Non-Communist Countries

With a few exceptions, the non-Communist countries have been economically little affected by the differential in trade controls. The exceptions are Hong Kong, Japan, and perhaps Macau, although the latter area has continued a limited trade in embargoed goods with mainland China.

Hong Kong has been an exception because of its geographical location and traditional role in the mainland China trade. It is largely dependent on mainland China for its food supply and many raw materials, and has in the past supplied many of mainland China's needs for manufactures.

A large part of Hong Kong's export market on the mainland was lost as a consequence of its imposition of CHINCOM controls. It expanded markets in other areas of Asia, however, for products which it manufactures as well as items of entrepot trade. As the Chinese Communists have also shown a reluctance to use Hong Kong in its traditional role as a trading center, preferring to trade directly with the countries involved, it is unlikely that maintaining the present controls or relaxing them to the COCOM level would substantially change Hong Kong's over-all economic position.

Japan is in a somewhat different situation because a relaxation of controls would permit it to export machinery, equipment, rolling stock, and other capital goods to Communist China. Although this circumstance would help to alleviate Japan's trade problems, it would fall far short of closing Japan's

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trade gap in the next few years. Two major factors militate against a reintegration of the economies of Japan and the Chinese mainland: a) Communist China is now firmly committed to a program of industrialization and integration of its economy with that of the Sino-Soviet Bloc; and b) Japan no longer possesses the political control over Manchuria which permitted it to develop that area as an integral part of its own economy and to make mainland China its most important trading partner.

III. ELIMINATION OF THE DIFFERENTIAL IN TRADE CONTROLS

A. Pressures for the Elimination of the Differential

There is continuing pressure for the elimination of the differential. Most foreign countries are opposed to applying a higher level of controls against Communist China than against the rest of the Communist Bloc. The non-Communist countries are motivated by neutralist sentiments and a desire to reduce international tension, *and the desire for increased trade.*

*as all as
by com-
mercial
considerations*

The attitudes of most non-Communist countries reflect primarily their respective views on Free World policies toward Communist China rather than any vital necessities arising from their trade situation. Since the Korean armistice, and particularly since the relaxation of trade controls against the European Soviet Bloc, political and commercial pressures have mounted within the various CHINCOM countries for a similar relaxation of trade controls against Communist China. These pressures stem in part from the belief that with the end of hostilities in Korea and Indochina, world tensions could be reduced and the chance for peace could be further improved by treating Communist China in the same manner as the rest of the Sino-Soviet Bloc. They also result from some feeling that especially since the reduction in COCOM controls, CHINCOM

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controls can be frustrated by transshipment through the European Soviet Bloc, with the consequence that such controls can have only minor adverse effects on Communist China's trade. Moreover, in some Asian countries, principally Japan, there is the feeling that differential controls give the Western European countries an advantage in the indirect trade with Communist China.

Economic pressures for lowering the level of controls against Communist China are important only in the case of Japan, the UK, and Portugal (because of Macau). In all countries including these, however, the attitude on the problem of China trade controls is considered only one aspect of the country's relations with the US. No major country would over-ride a firm US determination to hold the present policy. Maintaining present CHINCOM controls would, however, continue to be a minor source of irritation in US relations with certain other members of CHINCOM.

B. Economic Impact of Reduction of Trade Controls to COCOM Levels

If multilateral controls against Communist China were reduced to COCOM levels, the major impact would be to reduce the cost to Communist China of imports by \$30 million and since Japan would be in a position to negotiate further barter deals, Communist China could increase its exports to that country by another \$35-65 million a year. Another \$130-150 million in foreign exchange receipts would be available to Communist China, if the US were to eliminate its unilaterally imposed import and financial controls. No change would be made in the ability of Communist China to import any specific good not on the COCOM lists.

The economic impact on non-Communist countries of the reduction in trade controls to the COCOM level would be insignificant except for Japan where it would have, however, some slight effect.

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C. Raising Controls on the Sino-Soviet Bloc to CHINCOM Levels

The elimination of the differential in controls could also be achieved by raising the level of controls against the European Soviet Bloc. Such a policy would deny to Communist China some goods which can now be transshipped through Eastern European ports, (assuming that all COCOM members would agree to and enforce the changed control lists. The economic cost to Communist China would, therefore, be somewhat greater than the cost of the present differential. However, such a course of action does not now appear feasible, especially since it follows closely on the heels of a substantial reduction in COCOM controls against the European Soviet Bloc and since the USSR has not only been unprovocative of late but has made various positive conciliatory moves.

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Para 4 Page ~~8~~ II

I believe Chinese can receive
\$ for any authorized exports to U.S. - Perhaps
the implication is that there is a complete embargo.

Page ~~8~~ III

I mean that the economic (trade)
angle has definitely been glossed over. It
is undoubtedly of great importance for not
only U.K. but others such as Belgium,
Denmark etc

Page 7.

Third sentence in 2nd Para doesn't
make sense to me. - Maybe means
 $\frac{1}{2}$ of total budget.

Page 8 - 1st Sentence -

Seems unlikely they could be aware of
#5 of price index for 53 + 5% to derive estimate.

Page 10 is just what they said on page

III and it's still distorted wrong. Trade
advantage is probably most important factor.

*Revised unofficially
from 3/17/55 29 J
@ 16/15*

Comments on CFEF Paper No. 6:

"Differences in Free World Controls Over Trade with the
European Soviet Bloc and Communist China"

1. Page ii, paragraph #2 - It is stated that the economic burden of increased transport costs and premium prices amounted to \$30 million for the year 1954. This seems high. Page 6 of the text states that a premium of \$20 million was paid to Ceylon for rubber imports in 1954. This premium should be only \$12 million* (A Ceylonese profit of \$15 million on rubber, minus a Chinese profit of \$3 million on rice sold to Ceylon). The remainder of \$18 million in economic burden probably is meant to apply to unrecorded trade. The total value of goods transshipped through Gdynia is \$30 million, which probably includes very little additional transport cost inasmuch as it is often more economical to transship through Gdynia in order to accumulate a full load for China, and probably includes very little material purchased at premium prices, because CNIEC has apparently learned to bargain quite successfully with exporters in Western Europe. Therefore, it does not seem possible that more than \$5 million of the \$30 million Gdynia shipments could represent an economic burden of the kind referred to in the text. The remaining economic burden of \$13 million must apply to the balance of unrecorded trade, which totals only \$20 million. A more realistic estimate of this economic burden in 1954 might be \$20 million.

2. Page ii, paragraph #3 - While this text estimates that removal of controls would increase Chinese exports to Japan by \$35-65 million, NIE 100-55 estimates

*State, Colombo, D374, 18 Jan 55, Off. Use Only.

this value as \$35-50 million. This is not a significant difference.

3. Page ii, paragraph #4 - The text estimates that U.S. import and financial controls cost the Chinese \$130-150 million yearly. Page 5 of the text indicates that \$100 million of this total represents the amount of goods China could have sold in the U.S. in the absence of controls, while \$30-50 million represents remittances. However, page 7 of CFEP Study No. 5 states that China could sell only \$62 million of her exports in the U.S. in the absence of controls. NIE 100-55 estimates that removal of U.S. controls would result in a minimum gain to the Chinese of \$60 million in exports and \$30 million in remittances. This difference of \$40 million between minimum estimates of this text and of NIE 100-55 is considerable and becomes significant in a statement made on page iii of the text (see comment #4, following).

4. Page iii - The statement is made that U.S. controls plus the differential between COCOM and CHINCOM controls results in a minimum loss to China of \$195 million. This estimate of \$195 million is made up of:

- 1) \$30 million representing an economic burden due to premium prices and increased transport costs. This figure should probably be reduced to \$20 million for 1954, as indicated in comment #1.
- 2) A minimum loss of \$35 million in trade with Japan, which coincides exactly with the minimum estimate in NIE 100-55.
- 3) A minimum loss of \$130 million in trade and remittances with U.S., which is \$40 million more than the minimum estimate made in NIE 100-55 (due to the fact that both NIE 100-55 and CFEP Study No. 5 estimate possible Chinese sales in the U.S. of \$60 million, while this text estimates such sales of \$100 million).

In summary, this minimum loss of \$195 million estimated in the text is \$50 million higher than a comparable minimum estimate of \$145 million obtained from NIE 100-55 and the information in EIC-R1-S4.

5. Page 7 - It is estimated that Chinese imports of metals, machinery, and equipment in 1954 totalled "over \$700 million." Our estimate, in light of the work done for EIC-R1-S4, would be \$500-600 million, with \$600 million a maximum.
6. Page 7 - It is stated that the \$195 million of increased imports as a result of removal of differential controls would have increased Chinese investment by over 15 percent. The \$195 million is probably too high and should be nearer the \$145 million indicated in comment #4. Furthermore, it is assumed in the statement on page 7 that the Chinese would use the entire increase in exchange earnings to purchase capital goods. This may not be the case. It is possible that limitations of technical personnel and skilled workers would preclude an increase of 15 percent in investment^{in one year,} and it is also possible that a portion of the increased exchange may be used to purchase non-capital goods.
7. Page 11 - The estimates indicated in the first paragraph of Section B, page 11, reflect the same figures used previously in this text and discussed in the above comments.

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Irving I. Kramer
Executive Secretary

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By State Dept

Differences in Free World Controls Over Trade with
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Abstract

although not uniform

China There is at present a wide difference between the Western trade controls applied to Communist China¹ and those applied to the European Soviet Bloc. The stringent *China* embargo against exports of strategic goods to Communist China coupled with the August 1954 relaxation in the level of trade controls against Communist Europe by COCOM has resulted in a much *larger differential between the* longer list of goods which are embargoed for export to Communist China than to the European Soviet Bloc. In addition, *among other things* unilateral US controls prohibit importation of goods from and remittances of all kinds to Communist China.

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4. The most important single control applied against Communist China but not against the rest of the Soviet Bloc is the unilateral US prohibition on China's ability to receive ^{foreign exchange} ~~dollars~~ ^{direct or indirect} from the US for exports to or remittances from the US. It is estimated that this costs Communist China roughly \$130-150 million a year. The loss of the US market seriously curtails Communist China's ability to import goods from all sources including the rest of the Soviet Bloc.

The impact of these various controls can be seen when compared with the fact that Communist China's imports from all sources amounted to about \$1.25 billion in 1954. Thus, the differential in controls applied by countries other than the US cuts China's imports of all goods by at least

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Important

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3 alternatives
Elimination of differential:

Profit making
 Since the Geneva Conference pressure has been mounting among our allies to reduce controls against Communist China. Most countries are motivated either by neutralist sentiments or by a feeling that increased trade would reduce international tension and, therefore, the risk of armed conflict. The latter is important in the UK. Economic considerations are not large and are important only for certain Japanese businessmen and political leaders. Many Japanese also feel that their country is at a disadvantage vis-a-vis the Western European countries in the indirect trade with Communist China. Portugal is concerned because of Macau.

by reducing the Chinese level to the Communist level
 The elimination in the differential in export controls applied to Communist China would not, to repeat, allow that country to purchase goods which it otherwise could not have *obtained indirectly from* purchased in the West. It would reduce the cost of such purchases and increase the country's export earnings so that the total volume of trade might rise by *approx 1/4* 5 percent. Continuation of unilateral US financial controls would, of course, deny Communist China an increase of some 10 percent which it could otherwise achieve through its receipts of *foreign exch.* dollars *than direct exports and remittances.* from the US.

In addition there are approx \$100 M claimed by the Com. C. to be achieved in the elimination of the differential in controls could also be achieved by raising the level of controls against the European Bloc. Such a policy would deny to Communist China those goods which can now be transshipped through

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Eastern European ports, ~~[assuming that all COCOM members would agree to and enforce the changed control lists.]~~ However, such a course of action does not now appear ^{attainable,} ~~feasible,~~ especially since it follows closely on the heels of a substantial reduction in COCOM controls against the European Bloc and various positive conciliatory moves on the part of the USSR.

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I. DIFFERENCES IN LEVEL OF EXPORT CONTROLS AGAINST COMMUNIST CHINA AND THE EUROPEAN SOVIET BLOC

A. Historical Background

International agreement to apply unified trade controls against the European Soviet Bloc became effective in January 1950 with the establishment of a Coordinating Committee (COCOM) by the major Western allies to direct and coordinate trade control policies of the countries concerned. The COCOM countries, now numbering 15,¹ agreed to control three lists of commodities for the purpose of limiting the military potential of the Bloc. Goods on International List I (IL-I) are embargoed for shipment to the Bloc, goods on List II (IL-II) are subject to certain quantitative export controls, and goods on List III (IL-III) are subject to surveillance and exchange of information on shipments to the Bloc by the COCOM countries.

In June 1950 Communist China and north Korea were included in the scope of the export controls exercised by COCOM countries. In December 1950, after the Chinese Communist aggression in Korea, the US completely embargoed its trade and shipping with Communist China. In addition to trade controls maintained by other cooperating nations against Communist China, the US has put into effect the following unilateral controls:

1. ^{Blocking} Transaction and import controls which effectively prohibit ^{immobilize and} ^{prohibit} ^{remittance & other} ^{if goods of} ^{origin} imports from Communist China and the use of US dollars in transactions involving a Chinese Communist interest.

1. Member countries are: Belgium, Canada, Denmark, France, Greece, Germany, Italy, Japan, Luxembourg, the Netherlands, Norway, Portugal, Turkey, the UK, and the US.

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Shouldn't they be separated? Transmission controls also affect the Bloc.

2. Export controls which embargo all American goods to Communist China.
3. The denial of permission to American flag ships to visit Communist China and of their carrying any cargo intended for that country.
4. The prohibition of bunkering in the US of any foreign ships destined to call at Communist China within 120 days following, as well as the mandatory refusal by any American Petroleum Company of bunkering overseas of foreign ships carrying strategic cargoes to Communist China, either on outgoing or returning voyages.

After the UN embargo resolution of May 18, 1951, the COCOM countries expanded their controls on trade with Communist China, and 30 other countries imposed restrictions on their exports to Communist China. By the fall of 1952 all COCOM countries had agreed to embargo for shipment to Communist China all items on the three international lists as well as certain supplementary items, and organized the China Committee (CHINCOM) to coordinate these controls. Although enforcement measures have not been uniform, various COCOM countries have applied controls on their own merchant shipping, bunkering, transshipment of goods, ~~financial~~ *in strategic goods thru 3rd cos,* transactions, and have taken other measures to reinforce their trade control policies.

Trade controls against Communist China have thus become considerably more comprehensive than those applied against the USSR and Eastern Europe, and the gap between them was substantially increased in August 1954 when the

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COCOM countries agreed to a major relaxation in trade controls against the USSR and Eastern Europe. Trade controls against Communist China were maintained without ~~effective change~~ ^{significant modification}, however, and the COCOM countries agreed to consider measures to prevent or reduce the evasion of these controls by transshipment of goods through other Soviet Bloc countries, ^{+ Western?} the opportunities for which had obviously been increased by the relaxation of trade controls against the European Soviet Bloc.

B. Communist China's Foreign Trade

During the past five years Communist China's foreign trade has steadily expanded. Following the unification of the Chinese mainland under Communist control there was rapid progress in reconstruction, and Communist China's foreign trade more than doubled between 1950 and 1954, reaching the approximate equivalent, in constant dollars, of the highest prewar levels. At the same time Communist China has reoriented its trade toward the Soviet Bloc primarily because of Communist policies designed to isolate the economies of Bloc countries and to eliminate dependence on trade with the Free World. Of course, Soviet and satellite military and economic assistance has supported these policies, which have been given further impetus by Free World trade controls.

Estimates of Communist China's total trade, and its division between the Sino-Soviet Bloc and non-Communist areas, from 1950 to 1954 are presented in Table 1. (see next page).

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Table 1. COMMUNIST CHINA'S ESTIMATED TRADE WITH THE
SINO-SOVIET BLOC AND THE FREE WORLD, 1950-1954

| Year | Total trade In billions of US dollars | Percent of Total Trade ¹ | | | |
|------|---|-------------------------------------|---------|--|---------|
| | | Chinese Communist trade data | | By estimated origin and final destination | |
| | | Bloc | Nonbloc | Bloc | Nonbloc |
| 1950 | 1.1 | 26 | 74 | 26 | 74 |
| 1951 | 2.2 | 61 | 39 | 61 | 39 |
| 1952 | 1.8 | 72 | 28 | 67 | 33 |
| 1953 | 2.2 | 75 | 25 | 68 | 32 |
| 1954 | 2.5 | 80 | 20 | 75 | 25 |

1. Analysis of free world trade data and other intelligence indicates that Chinese Communist trade announcements since 1952 have exaggerated the extent of its reorientation toward the Sino-Soviet Bloc. This distortion is believed to reflect the "middleman role" played by European Soviet Bloc countries, which are believed to market Chinese Communist exports in Western Europe and to purchase controlled goods for transshipment to Communist China. Although this trade is with the free world, the Chinese Communists may record it as trade with the Sino-Soviet Bloc.

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II. ECONOMIC IMPACT OF PRESENT DIFFERENTIAL IN CONTROL

A. On Communist China

The differential in the trade controls applied to Communist China above those applied to the European Soviet Bloc has retarded the Chinese economic program by decreasing foreign exchange receipts and increasing import costs. The differential export controls have not denied to Communist China any goods which are available to the European Soviet Bloc though deliveries were delayed. These goods have been available to China after being transshipped from European Bloc ports. However, Communist China could have increased its total imports in 1954 by at least \$195 million or over 15 percent in the absence of differential trade controls. Of this, \$65 million is due to the differential in export controls; the remaining \$130 million flows from the unilateral US controls over dollar payments to Communist China.

Dealt with Commerce already

The US, which has been alone in closing its markets to Communist China's exports, took nearly \$150 million or over one-quarter of Communist China's exports in 1950. The US market was almost unique in its demand for such important Chinese exports as tung oil, bristles, feathers, embroideries, and handicrafts. These products could find only limited alternative markets and the resources used in their production being largely marginal in character were not easily diverted to other types of production. Although the US has found substitutes for some of these products and alternative sources of supply for others, Communist China could have increased its exports to the US in 1954 by an estimated \$100 million in the absence of unilateral import controls. Furthermore, US financial controls cost the Chinese Communists an estimated \$30-50 million in foreign exchange annually by prohibiting dollar remittances

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from overseas Chinese. The denial of these dollar funds from exports and remittances has annually reduced by \$130-150 million Communist China's foreign exchange receipts which could be used to purchase imports not on the COCOM lists whether or not the US reduced its export controls. *good*

The Japanese market for Chinese Communist exports ~~is extensive~~ *would be potentially if some imp't would* but tends to be competitive with that of the Soviet Union, which is now absorbing commodities that Japan formerly imported from China, such as coal, iron ore, salt, soybeans, hides, textile fibers, and other foodstuffs and raw materials. It is estimated that Japan could have absorbed a maximum of \$300 million of Communist China's exports in 1953, but this level of imports would have required a considerable reorientation of Communist China's trade. Given the absence of Japan's export controls and Communist China's relaxation of its political warfare campaign against Japan, Communist China could export to Japan \$75-100 million of goods annually (compared to \$40 million in 1954) without altering substantially its commitments to other markets and without foregoing the advantage of the higher prices prevailing in the Japanese market. *7*

See 8/1/54 Comments The Chinese Communists have been burdened with increased imports costs amounting to very roughly \$30 million in 1954. These added costs consisted of a premium of \$20 million above world market prices paid by the Chinese Communists to secure rubber from Ceylon, and at least \$10 million for other costs imposed by differential controls. Free World goods transshipped via the Eastern European Bloc in 1954 totaled 110,000 tons. Through direct shipments of these goods the Chinese Communists might have saved as much as \$3 million in transport costs alone. Moreover, through wider access to world markets -- such as the US market and the Japanese market -- Communist China could have purchased more

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competitively and thus at lower prices. Savings would have been especially significant in the cases of: a) the controlled commodities of Western European origin that are purchased through speculative elements and reach Communist China through circuitous channels, and b) petroleum shipments which constitute a considerable strain on the rail transport facilities of both the USSR and Communist China and which in the absence of CHINCOM controls could be secured by direct shipments at considerable savings.

In summary, the differential in trade and financial controls: 1) does not deny Communist China any specific goods, 2) decreases the availability of foreign exchange to Communist China by \$165-210 million per year, and 3) increases the cost of Chinese imports by at least \$30 million per year. This minimum total of roughly \$195 million amounted to over 15 percent of Communist China's imports from all sources in 1954. The cut is especially significant when one notes that imported metals, machinery and equipment, estimated at over \$700 million in 1954, constituted over one-half of the total investment in such items budgeted by the Chinese Communists in 1954. Thus, an added \$195 million could have increased such investment by over 15 percent.

The initial impact of the differential in trade controls on Communist China appears to ^{Proof? ch} have subsided, probably as a consequence of economic adjustments in both Communist China and its trading partners in the Sino-Soviet Bloc. Immediately after controls were imposed, the Chinese Communists offered high prices for strategic goods in Hong Kong. However, this situation changed after 1951, and by 1954 reports from Hong Kong indicated only sporadic interest on the part of Communist China to obtain strategic goods through illegal channels in Hong Kong. Exports of strategic goods from Macau, which had been a major

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loophole in the enforcement of trade controls, declined in 1954 compared to 1953 owing in part to action by the Portuguese Government to enforce controls, and in part to a lack of firm offers from the Chinese Communists. Trade in strategic goods through Hong Kong and Macau, both of which were high cost intermediaries for obtaining these materials, was apparently displaced in part by purchases from West European sources in 1953 most of which were transhipped to Communist China through European Soviet Bloc ports. These transshipments increased substantially during that year compared to 1952. However, the decrease in these diversions from non-Communist Europe during 1954 suggests that the Chinese Communists 1) have found alternative sources of supply in other countries of the Sino-Soviet Bloc, 2) have increased their domestic output sufficiently to satisfy more completely their needs for strategic goods, or 3) have been forced to reduce purchases because of shortages of foreign currencies and unfavorable barter trade balances given impetus by agricultural production shortfalls and saturation of foreign markets with typical mainland Chinese products. Combinations of all the factors, and other minor influences, are of course possible explanations of this decrease in diversions.

Butter enforcement?

export

Differential trade controls provide Communist China with an issue in their effort to isolate the US from its allies. Although controls hinder their efforts to achieve economic penetration of other Asian countries, the Chinese Communists continue to hold out the prospect of advantageous trade to these countries in order to arouse resentment toward the control system and policy conflicts with the US.

B. On Communist Europe

The impact of the differential in export controls has been slight on the countries of Communist Europe. Some of these countries, notably Poland, have engaged in a profitable transshipment trade. Others have undoubtedly supplied

only on overall impact - not qualitative

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Communist China with goods which it ordinarily received directly from the West. Since these exchanges have been on a ^{an} commercial basis, there has been no net cost and some economic gain to the countries of the European Soviet Bloc.

There is no evidence that the necessity for closer economic relations in the Sino-Soviet Bloc has had any marked impact on their political relationships.

C. On Non-Communist Countries

With a few exceptions, the non-Communist countries have been economically little affected by the differential in trade controls. The exceptions are Hong Kong, Japan, and perhaps Macau, although the latter area has continued a limited trade in embargoed goods with mainland China.

Hong Kong has been an exception because of its geographical location and traditional role in the mainland China trade. It is largely dependent on mainland China for its food supply and many raw materials, and has in the past supplied many of mainland China's needs for manufactures.

A large part of Hong Kong's export market on the mainland was lost as a consequence of its imposition of CHINCOM controls. It expanded markets in other areas of Asia, however, for products which it manufactures as well as items of entrepot trade. As the Chinese Communists have also shown a reluctance to use Hong Kong in its traditional role as a trading center, preferring to trade directly with the countries involved, it is unlikely that maintaining the present controls or relaxing them to the COCOM level would substantially change Hong Kong's over-all economic position.

Japan is in a somewhat different situation because a relaxation of controls would permit it to export machinery, equipment, rolling stock, and other capital goods to Communist China. Although this circumstance would help to alleviate Japan's trade problems, it would fall far short of closing Japan's

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trade gap in the next few years. Two major factors militate against a reintegration of the economies of Japan and the Chinese mainland: a) Communist China is now firmly committed to a program of industrialization and integration of its economy with that of the Sino-Soviet Bloc; and b) Japan no longer possesses the political control over Manchuria which permitted it to develop that area as an integral part of its own economy and to make mainland China its most important trading partner.

III. ELIMINATION OF THE DIFFERENTIAL IN TRADE CONTROLS

A. Pressures for the Elimination of the Differential

There is continuing pressure for the elimination of the differential. Most foreign countries are opposed to applying a higher level of controls against Communist China than against the rest of the Communist Bloc. The non-Communist countries are motivated ^{in part} by neutralist sentiments and a desire to reduce international tension. ^{or also by com. considerations}

The attitudes of most non-Communist countries reflect primarily their respective views on Free World policies toward Communist China rather than any vital necessities arising from their trade situation. Since the Korean armistice, and particularly since the relaxation of trade controls against the European Soviet Bloc, political and commercial pressures have mounted within the various CHINCOM countries for a similar relaxation of trade controls against Communist China. These pressures stem in part from the belief that with the end of hostilities in Korea and Indochina, world tensions could be reduced and the chance for peace could be further improved by treating Communist China in the same manner as the rest of the Sino-Soviet Bloc. They also result from some feeling that especially since the reduction in COCOM controls, CHINCOM

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controls can be frustrated by transshipment through the European Soviet Bloc, with the consequence that such controls can have only minor adverse effects on Communist China's trade. Moreover, in some Asian countries, principally Japan, there is the feeling that differential controls give the Western European countries an advantage in the indirect trade with Communist China.

Economic pressures for lowering the level of controls against Communist China are important only in the case of Japan, the UK, and Portugal (because of Macau). In all countries including these, however, the attitude on the problem of China trade controls is considered only one aspect of the country's relations with the US. No major country would over-ride a firm US determination to hold the present policy. Maintaining present CHINCOM controls would, however, continue to be a minor source of irritation in US relations with certain other members of CHINCOM.

B. Economic Impact of Reduction of Trade Controls to COCOM Levels

If multilateral controls against Communist China were reduced to COCOM levels, the major impact would be to reduce the cost to Communist China of imports by \$30 million and since Japan would be in a position to negotiate further barter deals, Communist China could increase its exports to that country by another \$35-65 million a year. Another \$130-150 million in foreign exchange receipts would be available to Communist China, if the US were to eliminate its unilaterally imposed import and financial controls. No change would be made in the ability of Communist China to import any specific good not on the COCOM lists.

The economic impact on non-Communist countries of the reduction in trade controls to the COCOM level would be insignificant except for Japan where it would have, however, some slight effect.

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C. Raising Controls on the Sino-Soviet Bloc to CHINCOM Levels

The elimination of the differential in controls could also be achieved by raising the level of controls against the European Soviet Bloc. Such a policy would deny to Communist China some goods which can now be transshipped through Eastern European ports, assuming that all COCOM members would agree to and enforce the changed control lists. The economic cost to Communist China would, therefore, be somewhat greater than the cost of the present differential. However, such a course of action does not now appear feasible, especially since it follows closely on the heels of a substantial reduction in COCOM controls against the European Soviet Bloc and since the USSR has not only been unprovocative of late but has made various positive conciliatory moves.

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